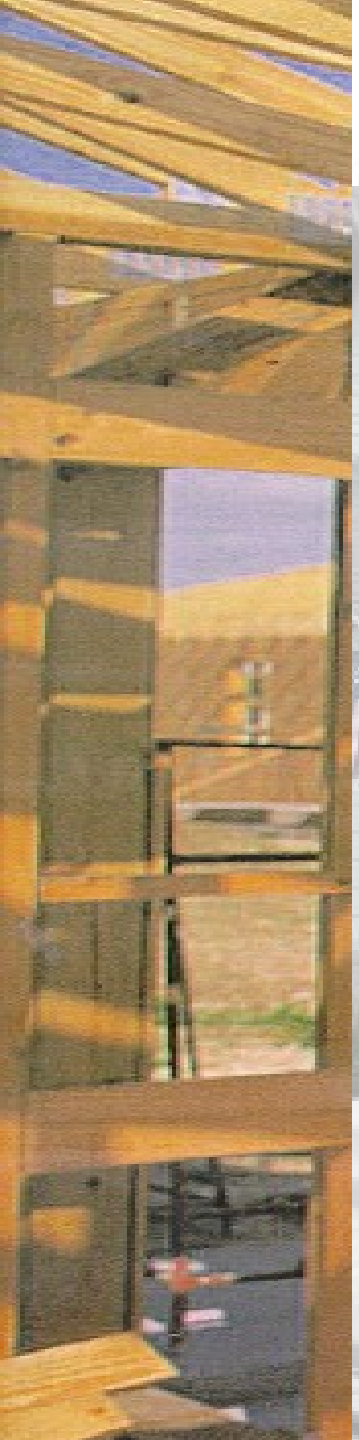

PHMA Conference

Military Housing Privatization Initiative (MHPI) - 101

presented by

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Office of the Secretary of Defense

Housing & Competitive Sourcing

& Ron Slusser/Kim Marchand (E&Y)

28 January 2004 (FINAL)

Agenda

- **Program Background and Legislative Mandate**
- **Understanding the MHPI Objectives**
- **Housing Privatization Process Overview**
- **Primary Legislative Authorities**
- **Why We Get More Housing *Now* using Privatization**
- **Why Government Contribution**
- **Proposal Evaluation Process**
- **Pre-/Post-Award Activities – Lessons Learned**

Program Background and Legislative Mandate

- **Shortage of quality, affordable housing available to service members and their families in local communities**
- **DoD Housing in need of repair:**

  Family Housing
  - 600,000 off-base / 15% unsuitable
  - 250,000 on base / 50% need repair
  - $16 billion - 20 years to resolve at current MILCON levels

  Unaccompanied Housing
  - 100,000 off-base
  - 450,000 on-base / 62% need repair
  - $9 billion - Indefinite period to resolve at current funding levels
- **Not enough MILCON $ to fix the problem**

Our Customer

Privatized Housing MCB Camp Pendleton, CA

Program Background and Legislative Mandate

- **1996 National Defense Authorization Act signed into law February 10, 1996**
- **2002 National Defense Authorization Act --Congress extended authority to Dec 31, 2012**
- **Major tools contained in law**
  - Direct Loans
  - Guarantees: Loan, Rent, Occupancy
  - Investments in Non-Governmental Entities
  - Limited Partnerships
  - Sell, Contribute, Convey, or Lease DoD-Owned Property
  - Differential Lease Payments
  - Lease Housing to be Constructed or Privately Owned Units
  - Assignment of Members and Use of Allotments

Understanding the MHPI Objectives

MACRO ISSUES

Current State

- Slow Government Process
- Old Housing
- Inadequate Resources
- Insufficient Capital

Potential Solutions

- Privatize Real Estate Assets and Services
- Outsource Services
- Dispose of Real Estate Assets

Future State

- Reduced Housing Deficit
- Streamlined Government
- Revitalized Housing
- Leveraged Funds with Private Resources/Expertise

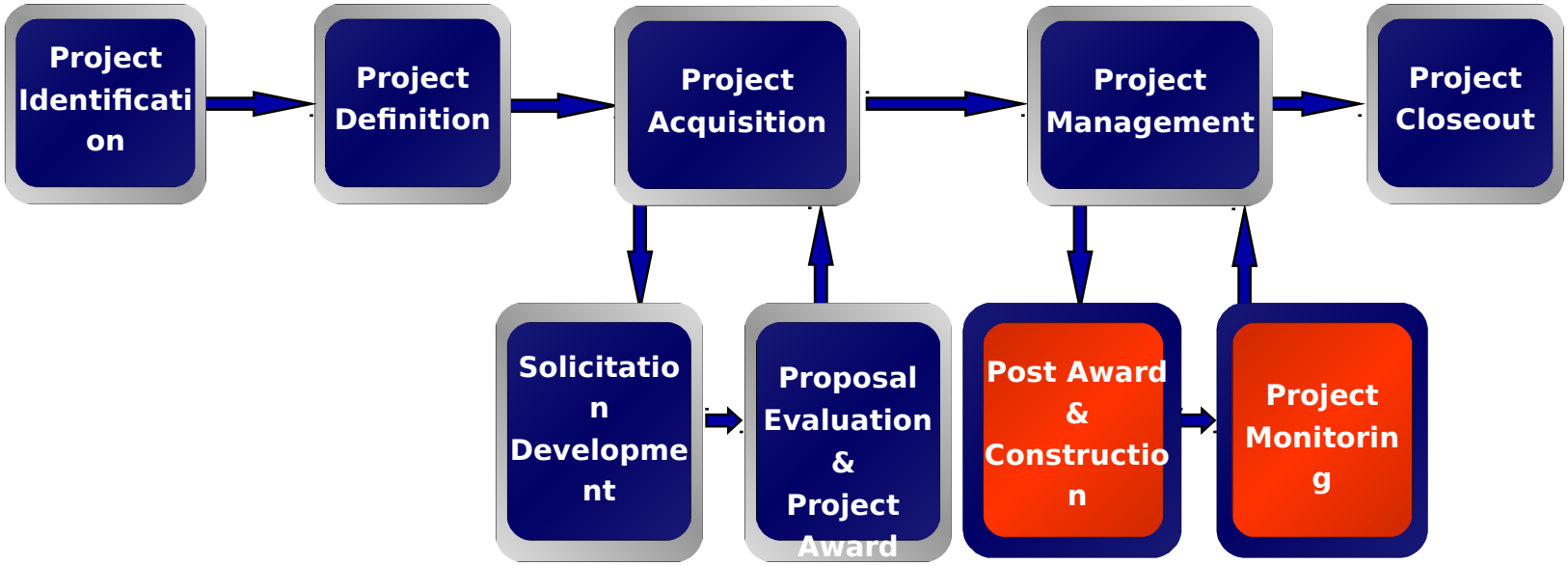
Military Housing Privatization Initiative

SOLUTIONS

Site* Nomination → Feasibility Assessment → RFQ/RFP Development → Proposal Evaluation → Award Contract → Post Award & Monitoring

*Local, Regional, National

Housing Privatization Process



Our Customer

Primary Legislative Authorities

Nine Broad Categories of Selected Tools Grouped in Three Areas:

- ***Real Estate Tools***
  - Conveyance and/or Lease
  - Rent & Occupancy Guarantees
  - Build-Lease
- ***Financial Tools***
  - Direct Loans
  - Loan Guarantees
  - Rental payment by Allotment
- ***Investment Tools***
  - Acquisition of Limited Partnership Interest
  - Stock
  - Bonds

Primary Legislative Authorities

Real Estate Tools - Conveyance or Lease Property

DoD may convey or lease property or facilities to people in the private sector who will use that property to provide suitable housing for service members.

Present Application

- Contribution of Government Assets
  - Ground lease of on-base military land
  - Conveyance of existing improvements and off-base land.

Primary Legislative Authorities

Real Estate Tools- Rent and Occupancy Guarantees

DoD may assure occupancy or rental income in non-governmental entities involved in the acquisition and/or construction of housing and support facilities.

Present Application

- Rental and Occupancy Guarantees are not a useful tool
  - Office of Management and Budget (OMB) scoring rules make this tool cost prohibitive

Our Customer

Primary Legislative Authorities

Real Estate Tools- Build/Lease

DoD may lease housing units to be constructed. Contract may include operations and maintenance.

Present Application

- Not generally considered a useful tool
  - Office of Management and Budget (OMB) scoring rules make this tool cost prohibitive

Primary Legislative Authorities

Finance Tools - Direct Loans & Guarantees

DoD may loan money for the acquisition or construction of suitable housing used for service members

DoD may guarantee loans made to people in the private sector if the proceeds of the loans are used to acquire or construct housing units suitable for service members

- Not to exceed 80% project value or outstanding loan balance, whichever is lower.

Primary Legislative Authorities

Finance Tools - Direct Loans & Guarantees (continued)

Present Application

- Very useful tools
  - Direct loans are effective tools for covering development gaps. Beneficial OMB scoring relative to other tools
  - Current loan guarantee product is a “limited guarantee”, which protects lenders from risk of base closure, downsizing and deployment -- does not cover economic or market risk.

Primary Legislative Authorities

Investments Tools

DoD may invest in non-governmental entities involved in the acquisition and/or construction of housing and support facilities

- Limited Partner
- Stock Purchase
- Bond Purchase
- Other equity or debt instruments
- Or any combination of above.

Primary Legislative Authorities

Investments Tools (continued)

Present Application

- *Useful Tool for Government contribution*
  - Current preferred structure for completed and contemplated Navy and Army transactions
  - No benefit from credit reform scoring

Why We Get More Housing *Now* using Privatization

- *Access to private capital*
  - Private debt (Banks and other financial sources)
  - Equity
- *Government contribution*
  - Land
  - Existing Housing
  - $ -- Debt, Equity, Subsidy
  - Housing Allowance

Why We Get More Housing *Now* using Privatization

	MILCON	Privatization
Life Cycle Cost (NPV)		$319M $287M (constant dollars)
Total Development Cost		$ 85.0M $79.4M
Gov't Appropriation	$ 85.0M	$23.3M
Leverage		3.4

Why Government Contribution

Authority | Appropriati

Construction Cost

$40M

Development Gap

$6M

Private Sector Mortgage
(based on 400 new units)

$30M

Developer Equity

$4M

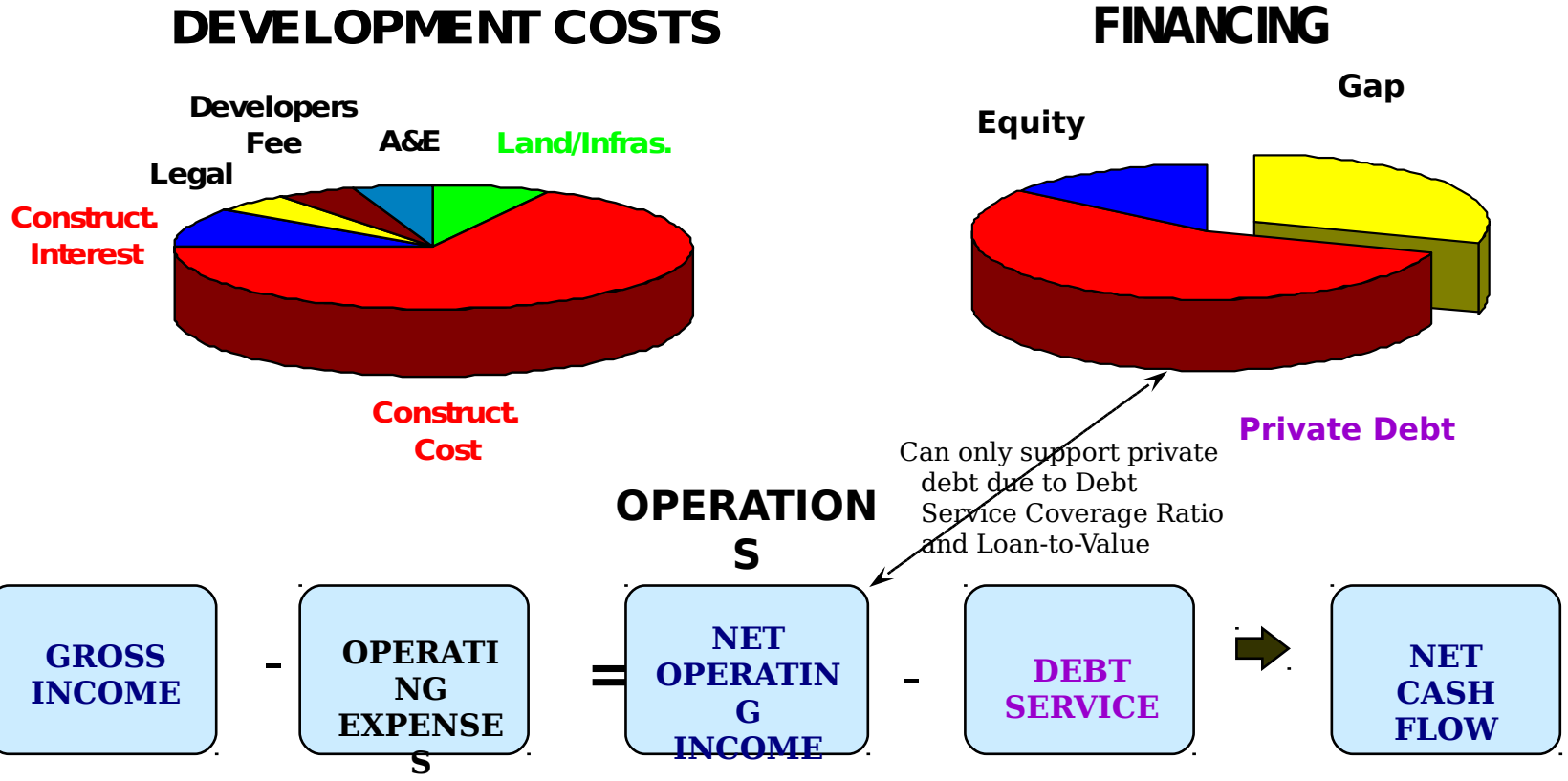
Direct Loan ***$3M***

Conveyed Units ***None***

Differential Lease Payments ***$5M***

Governm ent Equity ***$6M***

MHPI Real Estate Economics Base Case



= Rent
+ Other Income
- Vacation

= Maintenance, Management, Taxes, Insurance
+ Utilities
+ Replacement Reserves

= Return to Investors

Impact of MHPI Authorities

Tools	Impact on Project Economics & Scoring
Transfer of Land/Units	Reduces total development cost by reducing land cost • **No scoring impact**
Build to Local Standards	Reduces total development cost by reducing construction cost • **No scoring impact**
Limited Guarantee *(against base closure, downsizing, and deployment)*	Ensures availability of private financing and reduces interest rate • **Minimal scoring impact (3% - 7% of loan)**
Direct Loan	Brings additional financing through more favorable underwriting and below market interest rates • **Moderate to high scoring impact depending on interest rate subsidy and deferral**
Differential Lease Payments	Increases gross income • **High scoring impact**
Build to Lease/Occupancy Guaranty	Increases gross income and reduces interest rate by guaranteeing income • **High scoring impact**

Sample Project Assumptions

Project Scope	
Beginning Inventory	5482
Units Demolished	700
Demolition Cost per unit	$6,630
Units Renovated	4240
Renovation Cost per unit	$36,337
Replacement/Deficit New Construction	1300
New Construction Cost per unit	$99,000
Total Units @ Completion	6,082
Construction Period (New - 5 yrs, Revite - 10 yrs, Demo - 3 yrs)	10 Years
Total Units @ Completion	6,082
Operating Assumptions	
Weighted Average BAH/Month	$557
Average Utility Cost per Month	$164
Average O&M per Month	$146
Cost Year	1998
Inflation Rate	3%
BAH Growth Rate	3%
Expense Growth Rate	3%
Vacancy Rate	5%
Capital Reserve - During Construction/Thereafter	2%/6.5%
Deal Structure	
Developer Equity	10% of Total Development Costs
Debt Service Coverage Ratio	1.20
Amortization Period:	
Private 1st Mortgage:	30 Years
Direct Loan:	40 Years
Interest Rate:	
Baseline Scenario:	10.5%
Market, Limited Guarantee, Direct Loan, DLP:	7.5%
Occupancy Guarantee, Build-lease:	6.5%

MHPI Real Estate Economics Summar

($Millions)

	Market	Base Case	Local Standards	Transfer Of Land / Units	Limited Guarantee	Direct Loan*	Differentail Lease PMT	Build to Lease
Development Costs								
Land Acqusition/Unit Transfer	90	90	90	0	0	0	0	0
Construction Costs	245	272	255	255	255	255	255	255
Soft Costs	82	91	85	85	85	85	85	85
Total	417	453	429	340	340	340	340	340
Financing								
Private Debt	275	139	141	146	183	159	212	212
Government Debt	0	0	0	0	0	67	55	0
Contributed NOI**	0	91	88	100	92	83	41	96
Developer Equity	142	44	42	32	32	32	32	32
Gap	0	178	158	62	33	0	0	0
Stabilized Operations								
Effective Gross Income	50	39	39	39	39	39	45	41
Operating Expenses	26	25	25	25	25	25	25	25
Net Operating Income	24	14	14	14	14	14	19	16
Debt Service	20	12	12	12	12	12	16	13
Net Cash Flow	4	2	2	2	2	2	3	3
Internal Rate of Return	16%	16%	16%	16%	16%	16%	16%	16%
Scoring Impact	0	0	0	0	11	48	55	1092
Cumulative Scoring	0	0	0	0	11	59	68	1092

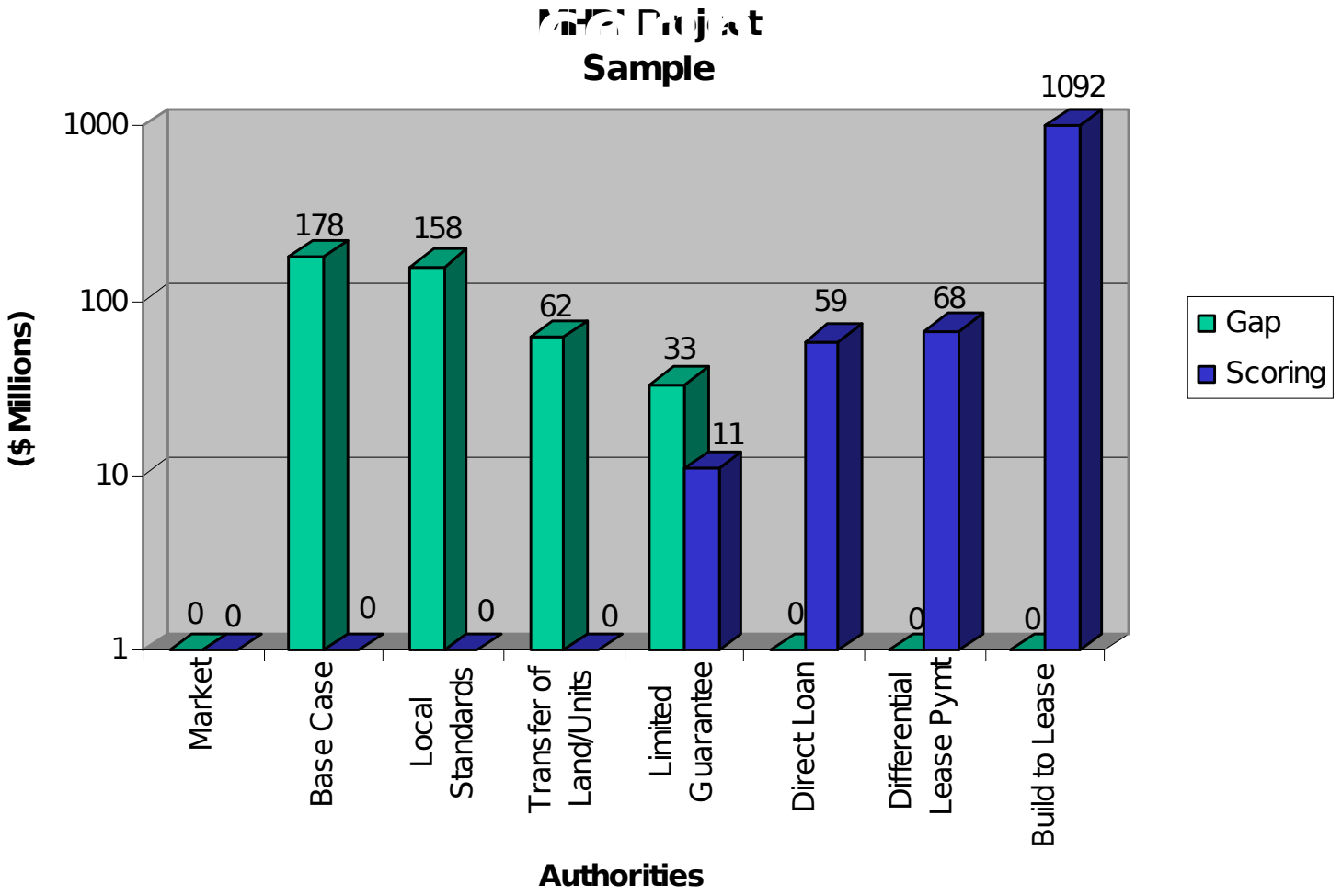
* This deal structure represents the preferred scenario, which combines the following authorities: local standards, transfer of units, limited guarantee, and direct loan.

** Income to the developer from conveyed units that is contributed to construction before debt service.

Scenario Descriptions

Market:	"Traditional" real estate transaction free of government regulation or subsidy
Base Case:	Privatization without benefit of MHPI Authorities
Local Standards:	Privatization using "local standard" authority
Transfer of Land/Units:	Privatization using "local standard" authority and the ability to transfer land and units.
Limited Guarantee:	Privatization using "local standard", transfer of land/units, and a limited guarantee against base closure, downsizing and deployment.
Direct Loan:	Privatization using "local standard", transfer of land/units, a limited guarantee, and a government direct loan
Differential Lease Payment:	Privatization using "local standard", transfer of land/units, a limited guarantee, and a government paid rental subsidy.
Build to Lease:	Privatization using "local standard", transfer of land/units, and the government guarantying rental or lease payments.

Impact of Authorities on GAP and



Pre-/Post Award Activities –

A. Pre-Closing/Award Activities
B. Establish Protocols
C. Inspection Process
D. Monitoring

Pre-Closing/Award Activities

- Identify pre-closing conditions
- Prepare and finalize legal documents
- Establish escrow, reserve and lockbox accounts
- Obtain required insurance coverage
- Participate in partnering session with installation (coordinate payment by allotment, town hall meetings, etc)
- Establish Management Review Committee (MRC)
- Finalize Transition Plan
- Ensure pre-closing conditions have been met

Establish Protocols

- Communications between developer and government, government and local municipality, schools, etc.
- Need for single point of contact (POC) between government and developer
- Assurance that mechanisms exist to address issues and problems
- Regularly scheduled partnering meetings between government designees and developer, with agenda and minutes

Inspection Process

- Understand levels of responsibilities under inspections:
  - Efficient inspection process should be in place, based on schedule and number of units built/renovated
  - Different inspection process under MHPI from MILCON
  - Purpose of inspections should be clearly communicated to government inspection team
  - Develop teaming protocol for inspections between the government and the developer
  - Develop a conflict resolution process for quickly and effectively addressing any

Monitoring

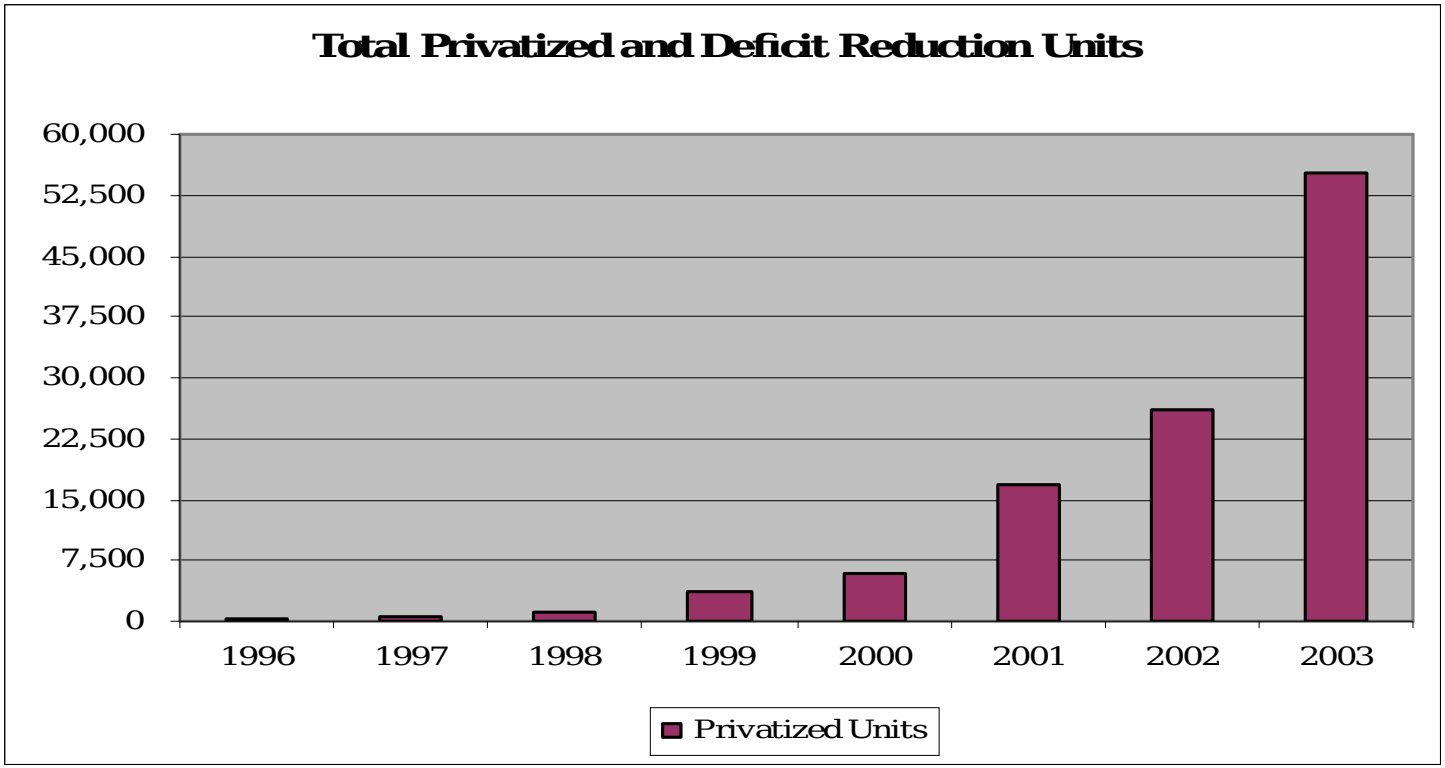
- Timing and types of data/information required to by MHPI projects:
  - Provided for in legal documents, through reporting requirements and rights of parties
  - Key is to have in place reporting standards and formats
- Military reviews and interprets data collected to evaluate impact on various aspects of project including how the construction schedule affects projected cash flows

Current Status of Program

- Goals: Privatize about 91,000 units by end of FY 2004, and 133,000 by the end of FY 2005.
- Eliminate nearly all inadequates by 2007– or about 120-130 K units
- Meet our goal to eliminate nearly all inadequates by 2007 is a Presidential Management Initiative
- Privatize over 75% of existing family housing inventory

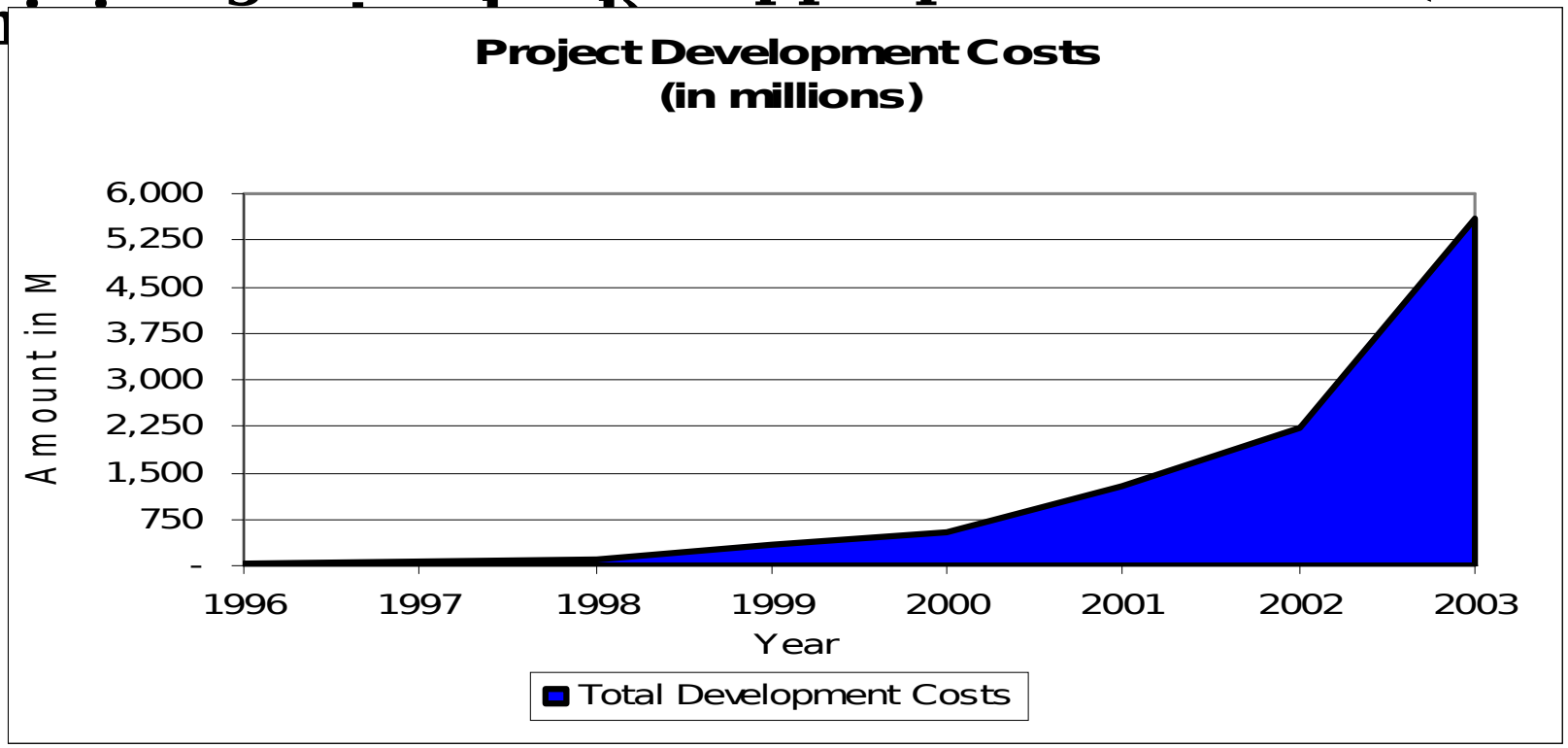
MHPI Program Growth

- **Over 55,000 total units privatized as of January 2004**
- **Over 29,000 units privatized in 2003 alone**
- **Program has more than tripled since FY 2001**



MHPI Project Costs

- **Private sector contribution over 85% of total**
- **Estimated value of $5.6 billion in total development costs**
- **Leverage of 12:1 for appropriated funds (3:1 is m**



Thank you --Information

Website

www.acq.osd.mil/housing

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